



# California Legislature

## Joint Legislative Audit Committee

GOVERNMENT CODE SECTION 10500 et al

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S. FLOYD MORI  
CHAIRMAN

May 1, 1980

1009

The Honorable Speaker of the Assembly  
The Honorable President pro Tempore of the Senate  
The Honorable Members of the Senate and the  
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's Letter Report on our review of the Department of Finance's Review of the Department of Motor Vehicles' Costs to Collect Use Taxes for the Board of Equalization.

The auditors are Curt Davis, CPA, Audit Manager; and Merrill Tompkins, CPA.

Respectfully submitted,

S. FLOYD MORI  
Assemblyman, 15th District  
Chairman, Joint Legislative  
Audit Committee

Attachment



THOMAS W. HAYES  
AUDITOR GENERAL

# California Legislature

## Office of the Auditor General



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April 18, 1980

Letter Report #1009

Honorable S. Floyd Mori,  
Chairman, and Members of the  
Joint Legislative Audit Committee  
State Capitol, Room 4168  
Sacramento, California 95814

Dear Mr. Chairman and Members:

We have reviewed the report of the Department of Finance on the Review of the Department of Motor Vehicles' Costs to Collect Use Taxes for the Board of Equalization (BOE). The department's report appears as an attachment to this letter. This review was conducted under the authority vested in the Auditor General by Section 10527 of the Government Code.

Supplemental language to Item 176 of the Budget Act of 1979 directed the Fiscal Management Audits Division of the Department of Finance (DOF) to determine the Department of Motor Vehicles' (DMV's) actual costs in collecting the use tax from the sale of vehicles between individuals. The division was then required to submit its report to the Joint Legislative Budget Committee and to the Joint Legislative Audit Committee. The language directed the Auditor General, upon approval of the Joint Legislative Audit Committee, to review the report of the Department of Finance and advise the Joint Legislative Budget Committee and the fiscal subcommittees as to the adequacy of the methods used by the Department of Finance in making its determination and in developing any subsequent findings.

We do not believe that the Department of Finance adequately responded to the supplemental language.

Honorable S. Floyd Mori,  
Chairman, and Members of the  
Joint Legislative Audit Committee  
April 18, 1980  
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DEPARTMENT OF FINANCE STUDY CONCLUSION

In the report submitted to the Joint Legislative Budget Committee and to the Joint Legislative Audit Committee on October 15, 1979, the Director of the Department of Finance stated that the DMV's current billing method should be maintained but should undergo two modifications. The report reads in part:

The methodology used in the current billing system should yield accurate costs, except that the standard times used cannot be directly verified. The results of comparisons made to validate the current billing system lead to the conclusion that the time standards include items of overhead and the application of the proposed indirect cost rate of 51.06 percent would result in overbilling. Therefore, until the standard times can be validated, the current system should be continued with the two modifications as explained in the report.

These are the two modifications as explained in the report:

First, DMV's use of a "Utilization Rate" in the calculation of "New Processing Costs" is inconsistent with its methodology for computing other use tax costs and should be eliminated. With this change the standard times (Line 2 of Exhibit II) for "Rating and Cashiering" and "New Processing Costs" can be combined for a standard time of 15.13 percent. Elimination of the Utilization Rate would decrease total costs billed by \$25,245.

Second, DMV and BOE should substitute an indirect cost rate for the four percent overhead rate currently used. Until the time standards have been validated and any indirect cost factors removed, the 51.06 percent rate should not be used in full. Once the time standards have been validated a full indirect cost rate should be applied as prescribed by SAM Section 8760. This change does not agree with the interdepartmental billing procedure in effect since 1963. Implementation of the 51.06 percent indirect cost rate without adjustment would increase annual billed costs by approximately \$1 million as shown in Exhibit V.

Honorable S. Floyd Mori,  
Chairman, and Members of the  
Joint Legislative Audit Committee  
April 18, 1980  
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AUDITOR GENERAL'S CONCLUSION

For the reasons stated in the explanation of the second modification of the billing system, we do not believe the Department of Finance adequately met the requirements of the supplemental language to Item 176 of the Budget Act of 1979. Although the DOF's finding concerning the second modification states that the "DMV and BOE should substitute an indirect cost rate for the four percent overhead rate currently used," it fails to provide any evidence as to how much the modification should be. We feel that until the indirect cost issue is resolved, no determination as to the Department of Motor Vehicles' actual cost in carrying out this program can be made.

Respectfully submitted,

A handwritten signature in cursive script that reads "Thomas W. Hayes".

THOMAS W. HAYES  
Auditor General

Attachments:

Response to Auditor General's Report  
Appendix A

cc: Mary Ann Graves, Director  
Department of Finance

**DEPARTMENT OF FINANCE**  
SACRAMENTO

April 8, 1980

Thomas W. Hayes, Auditor General  
Office of the Auditor General  
925 L Street, Suite 750  
Sacramento, CA 95814

SUBJECT: AUDITOR GENERAL REPORT ON DEPARTMENT OF FINANCE'S REVIEW OF  
DEPARTMENT OF MOTOR VEHICLES' COSTS TO COLLECT USE TAXES

I appreciate the opportunity to review and comment on the draft of your report on the Department of Finance's Review of the Department of Motor Vehicles' Costs to Collect Use Taxes for the Board of Equalization.

In your conclusion, you state, "We feel that until the indirect cost issue is resolved, no determination as to the Department of Motor Vehicles' actual cost in carrying out this program can be made." For this reason, you indicate you do not believe we have adequately met the requirements of the supplemental language.

The Department of Finance shares your concern regarding the resolution of the indirect cost issue. I am pleased to report that the Department of Motor Vehicles is currently in the process of automating its cost accounting system, which will provide for a more precise determination of both direct and indirect programmatic costs. Representatives of the Department advise they plan on utilizing the new system next fiscal year in determining the actual costs incurred in collecting Use Taxes for the Board of Equalization. I believe the indirect cost issue will be resolved with the installation of this new cost accounting system.

Should you desire a detailed briefing on the Department of Motor Vehicles' new cost accounting system, please contact John K. Harper, Principal Program Budget Analyst, telephone (916) 322-2263.

A handwritten signature in cursive script, appearing to read "Mary Ann Graves".

MARY ANN GRAVES  
Director of Finance

REVIEW OF THE  
DEPARTMENT OF MOTOR VEHICLES'  
COSTS TO COLLECT USE TAXES  
FOR THE  
BOARD OF EQUALIZATION

05-870-001  
OCTOBER 1979

FISCAL MANAGEMENT AUDITS  
DEPARTMENT OF FINANCE  
STATE OF CALIFORNIA

## DEPARTMENT OF FINANCE

SACRAMENTO



October 15, 1979

Honorable Walter W. Stiern, Chairman  
Joint Legislative Budget Committee  
925 L Street, Suite 650  
Sacramento, CA 95814

Honorable Richard Robinson, Chairman  
Joint Legislative Audit Committee  
925 L Street, Suite 750  
Sacramento, CA 95814

REPORT ON THE REVIEW OF THE DEPARTMENT OF MOTOR VEHICLES' COSTS TO  
COLLECT USE TAXES FOR THE BOARD OF EQUALIZATION, ITEM 176,  
FISCAL YEAR 1979-80

I am pleased to furnish this report on the Department of Motor Vehicles' costs to collect use taxes for the Board of Equalization as requested by the Supplemental Report of the Committee of Conference on the Budget Bill. This report, prepared by Fiscal Management Audits, describes the current billing system, the proposed changes and evaluates the appropriateness of the charges for collecting the use tax.

The methodology used in the current billing system should yield accurate costs, except that the standard times used cannot be directly verified. The results of comparisons made to validate the current billing system lead to the conclusion that the time standards include items of overhead and the application of the proposed indirect cost rate of 51.06 percent would result in overbilling. Therefore, until the standard times can be validated, the current system should be continued with the two modifications as explained in the report.

We would like to express our appreciation for the cooperation and assistance of the staffs of both departments in providing the information needed to prepare this report.

A handwritten signature in cursive script that reads "Mary Ann Graves".

MARY ANN GRAVES  
Director

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### List of Exhibits

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REVIEW OF THE DEPARTMENT OF MOTOR VEHICLES'  
COSTS TO COLLECT USE TAXES FOR THE  
BOARD OF EQUALIZATION

PURPOSE

This study was conducted to determine actual costs to the Department of Motor Vehicles to collect the use tax from the sale of vehicles between individuals. The 1979-80 Fiscal Year Supplemental Report of the Committee of Conference on the Budget Bill requested this study be performed and copies of the report be submitted to the Joint Legislative Budget Committee and the Joint Legislative Audit Committee.

BACKGROUND

The use tax is one of several different taxes and charges paid by the vehicle owner during the registration and licensing of a used vehicle acquired through a private sale. Since 1963 the Department of Motor Vehicles (DMV) has levied and collected the use tax at its field offices and the Sacramento headquarters office. Section 4750.5 of the Vehicle Code requires that the State Board of Equalization (BOE) enter into an agreement to reimburse DMV for the cost of collecting and transmitting the use tax to the BOE. For Fiscal Year 1978-79, DMV collected and remitted \$149,983,011 in use tax and was reimbursed \$2,766,825 for this service. Included in this is \$84,191 in costs incurred in collecting an additional use tax of one-half percent, as authorized by voter overrides to support regional transit operations for the Bay Area Rapid Transit District, the Santa Clara County Transit District, and the Santa Cruz Metropolitan Transit District. Exhibit I shows the amounts billed for collection costs for Fiscal Year 1978-79 by category. The agreement with BOE also has DMV collect Vessel Information. The cost of Vessel Information services was not reviewed as part of this study.

SCOPE AND METHODOLOGY

This study was limited to reviewing the accounting system of DMV as it relates to accumulating costs of collecting the use tax and verifying the accuracy of the data collected. We reviewed the source documentation for development of standards and the collection of data and verified the costs and billing calculations. The lack of documentation for some items limited our verification of the elements in DMV's current billing system.

DMV'S CURRENT BILLING SYSTEM

With the implementation of the use tax program in 1963, DMV conducted work measurement studies to develop a billing system based on standard times per transaction. This system has undergone only minor change from that first developed. Since the use tax program is administered and accounted for simultaneously with all other DMV field programs, it is not possible to determine actual cost of this program from the accounting system.

Accounting systems can be developed to accurately measure actual costs, but only if programs are discretely organized and accounted for. To determine actual costs with the current DMV program structure would require a very detailed, sophisticated cost accounting system that records and accumulates time and cost on each transaction. Such a system is very costly and may be unnecessary as actual costs can be approximated through the use of standard costs.

Sixteen years have elapsed since the standard times and the billing formula were developed and the personnel and documentation to validate the formula and standards are no longer available. We have summarized DMV's calculation of costs for collecting the use tax in 1978-79 in Exhibit II.

#### Direct Labor--Field Office Operations

- . Rating and Cashiering (Column 1) is the reviewing of documents, determining transaction type, inspecting or preparing supporting documents, assembling documents in sequence, stamping documents, computing the use tax and collecting the tax due. The item count is a computer produced record of use tax related registrations.
- . Use Tax RDFs, Report of Deposit of Fees, (Column 2), is the suspension of the registration process due to incomplete documentation. The applicable use tax is estimated and collected while the registration process is held in suspense. The registration of the vehicle is not processed until the documentation is completed and the final amount of the use tax paid, thus incurring additional processing costs. The item count for this function is manually kept by the field offices and reported to headquarters monthly.
- . Central Control Work (Column 3) is the accounting function of processing registrations at the Sacramento headquarters and the binding of registrations for transfer to Data Processing for further processing. The item count is a computer produced record of use tax related registrations.
- . New Processing Costs (Column 4) represent the additional cost of processing use tax documents due to changing the basis of the use tax from a table of fees (based on model/year/body style, etc.) to an actual bill of sale amount. This change increased use tax revenues, but also increased DMV customer contact and, consequently, collection costs. The item count again is a computer produced report of use tax related registrations.

The computations of the cost of performing the four activities differ in that for "New Processing Costs" a new factor utilization rate (Line 4) is introduced to recognize productivity loss. In addition, headquarters direct labor is excluded since there were no significant costs to headquarters associated with new processing.

EXHIBIT I  
SUMMARY OF 1978-79 FISCAL YEAR INVOICES  
BILLED TO THE BOARD OF EQUALIZATION BY  
THE DEPARTMENT OF MOTOR VEHICLES  
FOR COLLECTING USE TAX

|  | <u>Billed Costs</u>       |
|--|---------------------------|
| Regular Use Tax                          | \$2,250,083 <sup>1/</sup> |
| New Processing Costs                     | 432,551 <sup>1/</sup>     |
| Additional Tax for Regional Transit:     |                           |
| Bay Area Rapid Transit District (BART)   | 48,920                    |
| Santa Clara County Transit District      | 31,990                    |
| Santa Cruz Metropolitan Transit District | 3,281                     |
| Subtotal                                 | \$2,766,825               |
| Vessel Information                       | 28,976                    |
| TOTAL BILLED COSTS                       | \$2,795,801               |

<sup>1/</sup>Amounts differ slightly from those shown on Line 17 of Exhibit II due to rounding differences.

EXHIBIT II  
COMPUTATION OF COST TO COLLECT USE TAX AT THE  
DEPARTMENT OF MOTOR VEHICLES  
FOR THE 1978-79 FISCAL YEAR  
USING THE CURRENT BILLING SYSTEM

|   | (1)<br>Rating and<br>Cashiering | (2)<br>Regular Use Tax<br>RDFs | (3)<br>Central Control<br>Work | (4)<br>New<br>Processing<br>Costs |
|---|---------------------------------|--------------------------------|--------------------------------|-----------------------------------|
| <u>Direct Labor--Field Office Operations</u>                  |                                 |                                |                                |                                   |
| 1. Number of Use Tax Items                                    | 1,708,852                       | 190,900                        | 1,708,852                      | 1,708,852                         |
| 2. Standard Time Allowance                                    | .125                            | .079                           | .0005                          | .0263                             |
| 3. Direct Time (Line 1 x Line 2)                              | 213,606.5                       | 15,081.1                       | 854.4                          | 44,942.8                          |
| 4. Utilization Rate   | N/A                             | N/A                            | N/A                            | .949 <sup>1/</sup>                |
| 5. Hours Available for Work<br>(Line 3 + Line 4)              | N/A                             | N/A                            | N/A                            | 47,728.7 <sup>2/</sup>            |
| 6. Add 19% Leave Factor<br>(19% of Line 3)                    | 40,585.2                        | 2,865.4                        | 162.3                          | 9,068.4 <sup>3/</sup>             |
| 7. Total Paid Time (Line 3 + Line 6)                          | 254,191.7                       | 17,946.5                       | 1,016.7                        | 56,797.1 <sup>4/</sup>            |
| 8. Average Hourly Rate  | \$ 5.80                         | \$ 5.80                        | \$ 5.13                        | \$ 5.80                           |
| 9. Total Direct Labor--Field<br>Offices (Line 8 x Line 7)     | \$1,474,312                     | \$ 104,090                     | \$ 5,216                       | \$ 329,423                        |
| <u>Direct Labor--Headquarters</u>                             |                                 |                                |                                |                                   |
| 10. Administration  |                                 | \$ 4,568                       |                                | \$ --                             |
| 11. EDP   |                                 | 10,580                         |                                | --                                |
| 12. Registration  |                                 | 114,916                        |                                | --                                |
| 13. Total Direct Labor--Headquarters<br>(Lines 10, 11 and 12) |                                 | \$ 130,064                     |                                | --                                |
| <u>Departmental Costs</u>                                     |                                 |                                |                                |                                   |
| 14. Total Direct Labor<br>(Line 9 + Line 13)                  |                                 | \$1,713,682 <sup>5/</sup>      |                                | \$ 329,423                        |
| 15. Add Staff Benefits (27.3% of<br>Line 14)                  |                                 | 467,835                        |                                | 89,932                            |
| 16. Add Overhead (4% of Line 14)                              |                                 | 68,547                         |                                | 13,177                            |
| 17. TOTAL BILLED COSTS  |                                 | \$2,250,064                    |                                | \$ 432,532                        |

<sup>1/</sup>Rate was .934 for first quarter and .930 for second quarter.

<sup>2/</sup>Amount based on the applicable utilization rate and is the actual annual total.

<sup>3/</sup>19 percent of Line 5.

<sup>4/</sup>Line 5 + Line 6.

<sup>5/</sup>Line 9, Columns 1 + 2 + 3 + Line 13.

Field office direct labor costs are derived by applying the standard time allowance (Line 2) to the item count (Line 1) to determine direct time (Line 3). To direct time is added a leave factor (vacation, sickness and holidays) to arrive at total paid time (Line 7). The average hourly rate (Line 8) is based on the salaries and wages of the units providing service as presented in the Governor's Budget and is applied to total paid time to determine total direct labor--field offices (Line 9).

#### Computation of Direct Labor--Headquarters

Direct labor for headquarters consists of administrative support, electronic data processing and central processing of use tax registrations. These are services provided directly in support of the use tax program. The direct hours are arrived at by applying standard hours to the various tasks. The direct labor costs are determined by applying the average labor cost to the direct labor hours to determine the costs shown on Lines 10, 11 and 12.

#### Departmental Costs

Once the total direct labor costs (Line 14) have been determined, DMV adds staff benefits (Line 15) and overhead (Line 16), which are related to direct labor costs, to the total direct labor costs to determine the amount to bill BOE. The overhead rate of four percent of total direct labor cost was established in 1963 to cover operating expenses which include rent, utilities, supplies and departmental and state administrative support costs.

#### DMV'S WORK MEASUREMENT STANDARDS STUDY

In 1977, DMV proposed basing costs of collecting the use tax on work standards established under its Management Reporting and Control (MARC) System. MARC was developed by Booz, Allen and Hamilton in 1968 primarily as a method to identify work areas and procedures and set work standards for different tasks. Although MARC was abolished in June 1979 the work standards developed were used by DMV to determine the hours attributable to use tax collection in order to judge the reasonableness of the existing billing system. The calculated hours and costs for Fiscal Year 1978-79 using the MARC system are presented in Exhibit III and explained in the following paragraphs.

As the MARC standards are for performing a task in support of any DMV program and not just for the use tax program, DMV conducted a study to determine the percentage of the applicable task standards spent on use tax. Use tax labor hours were then calculated by multiplying the MARC system earned hours (the standard hours for doing the measured task during the period) by the use tax percentages for each task as determined by the DMV study. To the labor hours a utilization factor is applied to determine net hours available for use tax. Total paid hours are calculated by adding leave time and support time (training, time off for interviews, and miscellaneous administrative time off) to net available hours.

**ESTIMATED COST TO COLLECT USE TAX AT THE DEPARTMENT OF MOTOR VEHICLES  
FOR THE 1978-79 FISCAL YEAR USING THE MARC SYSTEM**

| <u>Work<br/>Standard<br/>Number</u>  | <u>Work Standard Name</u>              | <u>Earned<br/>Hours</u> | <u>Use Tax<br/>Percentage</u> | <u>Use Tax<br/>Direct Labor<br/>Hours</u> |
|--|--|-------------------------|-------------------------------|---|
| <b><u>Direct Labor - Field Office Operations</u></b>   |  |                         |                               |   |
| 25   | Report of Deposit of Fees (Counter)    | 265,911.5               | .1600                         | 42,545.8                                  |
| 26   | Report of Deposit of Fees (Noncounter) | 40,780.8                | .0820                         | 3,344.0                                   |
| 27   | Transfer (Counter)                     | 203,659.1               | .2619                         | 53,338.3                                  |
| 28   | Transfer (Noncounter)                  | 62,849.3                | .0690                         | 4,336.6                                   |
| 31   | Nonresident Transfers (Counter)        | 70,352.3                | .1094                         | 7,696.5                                   |
| 32   | Nonresident Transfers (Noncounter)     | 5,534.5                 | .0780                         | 431.7                                     |
| 35   | Miscellaneous Counter Transactions     | 86,265.7                | .0278                         | 2,398.2                                   |
| 36   | Miscellaneous Noncounter Transactions  | 13,117.7                | .0264                         | 346.3                                     |
| 38   | Specialized Cashiering                 | 520,693.9               | .0458                         | 23,847.8                                  |
| 39   | Generalized Cashiering                 | 57,872.3                | .0458                         | 2,650.6                                   |
| 44   | Automobile Club Transactions           | 23,050.6                | .1100                         | 2,535.6                                   |
| 45   | Holdouts                               | 11,013.1                | .0650                         | 715.8                                     |
| 50   | Registration Miscellaneous             | 309,448.4               | .0766                         | 23,703.7                                  |
| 51   | Audit Cashier Daily Record             | 109,070.1               | .2056                         | 22,424.8                                  |
| 52   | Audit Automobile Club Cashier Record   | 10,059.4                | .2056                         | 2,068.2                                   |
| 55   | Balance Cashier                        | 62,678.4                | .1990                         | 12,473.0                                  |
| 56   | Cash Control                           | 35,869.8                | .1131                         | 4,056.9                                   |
| 57   | Prepare Clearance                      | 25,675.0                | .1732                         | 4,447.0                                   |
| 60   | Cashiering Miscellaneous               | 26,098.0                | .1683                         | 4,392.3                                   |
| <b>Total Direct Labor</b>  |  |                         |                               | <b>217,753.1</b>                          |
| <b><u>Indirect Labor - Field Office Operations</u></b>   |  |                         |                               |   |
| 91   | Administration                         | 717,281.7               | .0546                         | 39,163.6                                  |
| 96   | Varied Office Hours Phone Coverage     | 1,073.0                 | .0546                         | 58.6                                      |
| 97   | Stockroom and Mailroom                 | 8,224.5                 | .0546                         | 449.1                                     |
| 98   | Travel Crew Travel Hours               | 14,970.5                | .0546                         | 817.4                                     |
| 99   | Janitor                                | 216,817.4               | .0546                         | 11,838.2                                  |
| <b>Total Indirect Labor</b>  |  |                         |                               | <b>52,326.9</b>                           |
|  |  | <u>Direct Labor</u>     | <u>Indirect Labor</u>         | <u>Total</u>                              |
| <b><u>Departmental Costs</u></b>   |  |                         |                               |   |
| Total Field Office Labor Hours   |  | 217,753.1               | 52,326.9                      | 270,080.0                                 |
| Divided by 93.6 percent utilization rate for<br>Productivity Inefficiency to calculate:<br>(Total Labor Hours ÷ Total Available<br>Hours = Utilization Rate) |  |                         |                               |   |
|  |  | 232,642.2               | 55,904.8                      | 288,547.0                                 |
| Add: Leave Time of 17.0 Percent  |  | 39,549.2                | 9,503.8                       | 49,053.0                                  |
| Add: Support Time of 7.1 Percent   |  | 16,517.6                | 3,969.2                       | 20,486.8                                  |
| Total Paid Hours - Field Office Operations   |  | 288,709.0               | 69,377.8                      | 358,086.8                                 |
| Multiply by Labor Cost per Hour  |  | \$5.80                  | \$5.80                        | \$5.80                                    |
| Total Paid Hours Value - Field Office<br>Operations  |  | \$1,674,512             | \$402,391                     | \$2,076,903                               |
| Add: Total Direct Labor - Headquarters<br>(from Line 13, Exhibit II)   |  | 130,064                 | ---                           | 130,064                                   |
| TOTAL LABOR COSTS  |  | \$1,804,576             | \$402,391                     | \$2,206,967                               |
| Add: Staff Benefits of 27.3 Percent  |  | 492,649                 | 109,853                       | 602,502                                   |
| Add: Overhead of 4.0 Percent   |  | 72,183                  | 16,096                        | 88,279                                    |
| TOTAL COSTS  |  | \$2,369,408             | \$528,340                     | \$2,897,748                               |

The comparable cost of use tax collection using the MARC based standards were calculated by multiplying total paid time by the current labor cost per hour, and adding staff benefits and overhead at the existing rates for the current billing system.

#### Factors Affecting Cost Computation

The major factors in calculating use tax standard costs are work item counts, standard time per work item counted, use tax percentage, and cost per standard labor hour.

The work item counts of tasks performed are sent monthly to Sacramento headquarters. These counts are not reconciled to any documentation counts, such as the actual number of use tax registrations, partly because the work standards do not always correlate to single documents. For example, counts of transfers can use either the Certificate of Ownership form or the Application for Duplicate Ownership form, while miscellaneous counter transactions can use any of 16 different forms in the count.

The work standards apply a standard time to the item counted. The standard time consists of time measured by a time study or other observation, plus a 15 percent factor for "personal, fatigue and delay," or PFD. The PFD is calculated as part of the work standard itself.

We were unable to review the studies done to calculate use tax work standards due to a lack of documentation available at DMV during the period of our study. We were told by DMV that time standards were developed by work sampling and time and motion studies.

The calculation of the percentage of earned hours applicable to use tax collection was the result of a DMV review of nine field offices. At each office, work factors were counted to determine the percentage of the function applicable to the use tax program. We reviewed the work counts, the calculation of use tax percentages by field office, and the process used to calculate the average percentage of work standards applicable to the use tax. We accept that the DMV study adequately calculates the percentage of work standards applicable to the use tax.

The cost per standard labor hour was applied by us during our study. We used the same rate as that used by DMV for the BOE billing cost determination, \$5.80 per hour, as derived from the Governor's Budget.

Although DMV has used the MARC based study only for informal comparison with the current billing system, portions are used as a basis for headquarters' costs and "New Processing Costs" in the current billing system.

## DMV'S PROPOSED INDIRECT COST RATE

Historically, DMV has added an overhead charge of four percent to direct labor costs to recover part of its operating expense. Now, DMV wishes to change this agreement with BOE and substitute a newly developed departmental indirect cost rate of 51.41 percent applied against direct labor charges.

The 51.41 percent rate complies with the requirements of Section 8760.1, State Administrative Manual (SAM), and includes overhead of all divisions in the department without regard to whether or not they contributed to the services rendered. For example, the divisions of Drivers Licenses and Compliance do not provide any effort in the collection of use tax. While the Division of Field Office Operations collects a large portion of the use tax, and the Division of Registration processes the more unusual use tax transactions. The Accounting Office in the Administration/Executive Division and the EDP Division record and forward collections to the Board of Equalization.

DMV's calculation of its indirect cost rate is shown in Exhibit IV (prepared by DMV), and is explained below.

Total expenditures (Column 1) were taken from DMV's monthly budget reports for the period May 1, 1977 to April 30, 1978.

Indirect costs for departmentwide (Column 2) and division (Column 3) expenditures are calculated alike. Indirect labor costs are computed by applying the annual average salary for each classification to the number of indirect staff in that classification. To the annual labor costs are added staff benefits of 27.3 percent of indirect staff annual cost to determine total annual indirect staff costs. To this is added indirect operating expenses to arrive at total indirect costs.

Direct Operating Expenses (Column 4) are expenditures unique to the division incurring the expense. Examples are vehicle license plates, vehicle stickers, bicycle stickers, vessel registration stickers and forms, postage in the Division of Registration, and fingerprint costs, photo-occupational license, postage and post licensing control costs in the Division of Compliance.

Direct labor costs (Column 5) are calculated by deducting departmentwide and division indirect costs and operating expenses from total expenditures.

We found that DMV made a computational error in the calculation of indirect labor costs. Industrial disability leave and nondisability insurance costs, which are included in staff benefits, were erroneously accumulated in the calculation of indirect labor costs.



EXHIBIT IV  
DEPARTMENT OF MOTOR VEHICLES  
CALCULATION OF INDIRECT COST RATES  
FOR THE PERIOD MAY 1, 1977 TO APRIL 30, 1978

| <u>Cost Center or Division</u> | (1)<br><u>Total Expenditures</u> | (2)<br><u>Departmentwide Indirect Costs</u> | (3)<br><u>Division Indirect Costs</u> | (4)<br><u>Direct Operating Expenses</u> | (5)<br><u>Direct Labor Costs</u> |
|--------------------------------|----------------------------------|---|---------------------------------------|---|----------------------------------|
| New Motor Vehicle Board        | \$ 173,260.95                    | \$ .00                                      | \$ .00                                | \$ 65,679.61                            | \$ 107,581.34                    |
| Administration and Executive   | 12,630,319.06                    | 9,103,548.70                                | 1,410,558.31                          | 363,642.65                              | 1,752,569.40                     |
| Field Office Operations        | 50,027,826.96                    | 813,653.12                                  | 8,817,613.19                          | 1,165,108.52                            | 39,231,452.13                    |
| Registration                   | 23,804,460.49                    | 460,485.85                                  | 3,310,137.04                          | 8,480,316.15                            | 11,553,521.45                    |
| Drivers Licenses               | 25,068,312.49                    | 628,675.19                                  | 3,982,935.34                          | 4,100,098.42                            | 16,356,603.54                    |
| Compliance                     | 8,703,221.53                     | 825,135.81                                  | 2,837,339.08                          | 170,640.65                              | 4,870,105.99                     |
| EDP Services                   | 18,350,590.27                    | 4,123,310.50                                | 2,046,289.08                          | 85,816.82                               | 12,095,173.87                    |
| Facilities Costs               | <u>5,834,433.71</u>              | <u>5,834,433.71</u>                         | <u>.00</u>                            | <u>.00</u>                              | <u>.00</u>                       |
| Totals                         | \$144,592,425.46                 | \$21,789,242.88                             | \$22,404,872.04                       | \$14,431,302.82                         | \$85,967,007.72                  |

CALCULATION OF INDIRECT COST RATE:

|                |  |        |
|----------------|--|--------|
| Departmentwide | \$21,789,242.88 (Col. 2) ÷ \$85,967,007.72 = | 25.35% |
| Division       | \$22,404,872.04 (Col. 3) ÷ \$85,967,007.72 = | 26.06% |

Total Departmental Indirect Cost Rate

51.41%

Source of Column 1:  
Financial Statement  
Budget Reports, May 1, 1977 to April 30, 1978

The cost of industrial disability leave and nondisability insurance for the period May 1, 1977 to April 30, 1978 was \$317,101.72. This amount divided by total direct labor costs indicates that the overhead rate is overstated by 0.35 percent. The correct indirect cost rate should be 51.06 percent.

The methodology used by DMV to calculate the indirect cost rate complies with the instructions of SAM Section 8760.1.

### CONCLUSION

We were able to directly verify two major factors of the current billing system, item count and hourly rate. However, we were unable to directly verify the third factor, standard time allowance. Therefore, we had to verify this factor by comparing the total cost of the work measurement system with the current billing system. The comparisons of the current billing system and MARC system show similar costs. This occurs even though we know MARC includes factors such as utilization rate, support time and PDF which are generally thought of as overhead. Logic then would indicate that the current billing system's standard times include some factor for overhead related items and to that extent would result in overbilling if the full indirect rate of 51.06 percent were applied. Therefore, we feel the standard time in use is subject to question. An independent third party, experienced in time and motion techniques, should be selected to validate the standard time in use. Until then the current system should be continued with two modifications.

First, DMV's use of a "Utilization Rate" in the calculation of "New Processing Costs" is inconsistent with its methodology for computing other use tax costs and should be eliminated. With this change the standard times (Line 2 of Exhibit II) for "Rating and Cashiering" and "New Processing Costs" can be combined for a standard time of 15.13 percent. Elimination of the Utilization Rate would decrease total costs billed by \$25,245.

Second, DMV and BOE should substitute an indirect cost rate for the four percent overhead rate currently used. Until the time standards have been validated and any indirect cost factors removed, the 51.06 percent rate should not be used in full. Once the time standards have been validated a full indirect cost rate should be applied as prescribed by SAM Section 8760. This change does not agree with the interdepartmental billing procedure in effect since 1963. Implementation of the 51.06 percent indirect cost rate without adjustment would increase annual billed costs by approximately \$1 million as shown in Exhibit V.

EXHIBIT V  
CURRENT BILLING METHOD AND WORK MEASUREMENT  
STUDY METHOD ADJUSTED TO REFLECT PROPOSAL  
AND RECOMMENDED MODIFICATIONS

|   | Current<br>Billing Method<br>(Exhibits I & II) | Work Measurement<br>Method<br>(Exhibit III) |
|---|--|---|
| 1. Total Costs  | \$2,766,825                                    | \$2,897,748                                 |
| 2. Indirect Costs   | -0-  | 528,340                                     |
| 3. Total Labor Costs  | 2,107,254*                                     | 2,206,967                                   |
| 4. Direct Labor Costs   | 2,107,254*                                     | 1,804,576                                   |
| 5. Overhead Charges (4% of<br>Line 4)                               | 84,290   | 72,183                                      |
| 6. DMV's Proposed Indirect<br>Cost Rate (0.5106 x<br>Line 4)        | 1,075,964                                      | 921,417                                     |
| 7. Elimination of "New<br>Processing Costs"                         | (25,245) *                                     | -0-   |
| 8. Application of Indirect<br>Cost Rate (Line 6 -<br>Lines 2 and 5) | 991,674  | 320,894                                     |
| 9. Total Both Modifications<br>(Line 7 + Line 8)                    | 966,429  | 320,894                                     |
| 10. Total Costs as Modified<br>(Line 1 + Line 9)                    | \$3,733,254                                    | \$3,218,642                                 |

\*Computed for comparative purposes only.